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Floor Statement of Senator Charles E. Grassley
A $1 Trillion Stimulus?
Let's Look Before We Leap
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Our nation's fiscal outlook is grim. The Congressional Budget Office, projects the federal budget deficit will exceed $1 trillion this year. Despite this enormous deficit, President Obama is urging Congress to enact a massive stimulus plan that would add another $1 trillion in government debt over the next ten years. The President and his advisors insist we must spend this money as quickly as possible in order to save our economy.

In normal times, such fiscal excess would be widely criticized and promptly rejected. But, these are not normal times. We are told our economy faces the worst recession since the Great Depression. While such comparisons may be overblown, everyone is understandably concerned about the present state of our economy. Congress needs to take action to address declining growth and rising unemployment. But, we must not let our desire for a quick fix undermine our ability to address the real challenges we face.

A sustainable fiscal policy depends on a growing economy; and a sound economy depends on a sound fiscal policy. Unfortunately, there does not seem to be any consensus on what constitutes sound policy.

There are two opposing views on the economy. Some people say consumption is the key to economic growth. When people go shopping, the economy is good. According to this view, we need to spend more. Other people say investment is the key. When businesses invest, the economy is good. According to this view, we need to save more.

Some economists try to reconcile these opposing views by suggesting the correct view depends on the circumstances. When workers are fully employed and factories are fully utilized, they say we need to save more and increase supply. But, when workers are unemployed and factories are idled, they say we need to spend more and increase demand. While this explanation is appealing, it does not withstand careful scrutiny.

We are told that in order to stimulate the economy, all the government has to do is put money into the hands of consumers and they will spend us back into prosperity. The problem with this approach is that the only way the government can put money in someone's hands is by taking it from someone else's pockets – either in the form of taxes or borrowing.

This is a zero sum game in which one person's loss is another person's gain. Some economists try to obscure this fact by introducing a concept known as the marginal propensity to consume. That's a fancy way of saying some people spend more of their money than others.

According to this concept, low-income people are more likely to spend an extra dollar than high-income people. Thus, taking money from the rich and giving it to the poor will stimulate consumer demand and boost the overall economy.

This concept is flawed because it ignores the role of saving. Money that is saved does not disappear; it flows back into the economy in the form of business loans or consumer credit. Saving is just another form of spending, specifically, spending on capital goods like factories and equipment, or consumer goods like cars and houses.

Of course, the critics say this is not always true. During a recession banks are less willing to lend and businesses are less willing to borrow. Thus, some of the money previously available in the economy is no longer being used. It has been stuffed under the proverbial mattress, so to speak. Thus, advocates of fiscal stimulus claim the government can borrow and spend during a recession without crowding-out other private sector spending.

This is true only in the narrow sense that increasing the money supply allows the government to borrow and spend without reducing the amount of money available to others. But, in that sense this is really an argument about monetary policy masquerading as fiscal policy. Moreover, when the government borrows money, whether it is new money or old money, what the government is really borrowing is the resources it acquires. Thus, every dollar the government spends has an opportunity cost in terms of the potential alternative uses of those resources.

Much of the confusion over this point comes from the failure to recognize the nature of money in our economy. Economists often talk about the multiplier effect in order to explain how each dollar of government spending can result in more than a dollar of economic activity.

But, the multiplier effect is simply a way of illustrating the fact that if I give you a dollar, you will spend part of it and save part of it. The portion you spend goes to someone, who spends a portion and saves a portion, and so on, and so on…. Thus, one dollar effectively multiplies into many dollars.

Contrary to what some people might have you believe, the multiplier effect applies to every dollar, not just those spent by the government. According to Federal Reserve data over the past 50 years the ratio between our Gross Domestic Product and our money supply – defined as currency plus bank reserves – has ranged from 10-to-1 to 20-to-1. In other words, every dollar in our economy supports between ten and twenty dollars of economic activity.

During a recession, there are fewer workers producing fewer goods and services. That is why it is called a recession. Because the level of output is lower, the level of spending is lower as well. That means the available dollars are being used less. Economists often refer to this as a decline in the velocity of money.

The money no longer being used reflects the goods and services no longer being produced. With fewer goods and services available to buy, government efforts to borrow and spend will increase the money supply. Instead of the Federal Reserve increasing bank reserves to boost private lending, the government will increase borrowing to boost private spending. But, this is really monetary policy disguised as fiscal policy.

The success or failure of this policy will depend on how the additional money is used. Unfortunately, when some advocates of government stimulus talk about priming the pump, they give the impression that we can grow our economy by simply spending money, and it doesn't matter how we spend it.

Consider the following comments from John Maynard Keynes:

"If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coal mines… and leave it to private enterprise… to dig the notes up again… there need be no more unemployment…"

Nearly everyone would recognize the ill effects of printing up $1 trillion and dropping it from helicopters. But, what if the government hired ten million Americans to dig holes and fill them back up, and paid them each $100,000? Would this prime the pump, and get our economy moving again? The answer should be obvious – it would be a complete waste of resources.

The 19th century economist Fredrick Bastiat once observed, "There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen."

When the government borrows money for some activity that is what is seen. But what is not seen is what could have been created had those workers and resources been used in some other way. The benefit of a government stimulus plan must be weighted against the cost. So far, there has been no comprehensive cost-benefit analysis of the proposed stimulus bill. This is a glaring omission given the recent comments that have been made by President Obama.

Shortly before his inauguration, President Obama gave a series of speeches and interviews. I would like to read a couple of sentences from them.

According to the January 16th Washington Post:

“Obama repeated his assurance that there is ‘near-unanimity’ among economists that government spending will help restore jobs in the short term, adding that some estimates of necessary stimulus now reach $1.3 trillion.

“The president-elect said he believes that direct government spending provides the most "bang for the buck" and that his advisers have worked to design tax cuts that would be most likely to spur consumer and business spending.

“ ‘The theory behind it is I set the tone,’ Obama said. ‘If the tone I set is that we bring as much intellectual firepower to a problem, that people act respectfully towards each other, that disagreements are fully aired, and that we make decisions based on facts and evidence as opposed to ideology, that people will adapt to that culture and we'll be able to move together effectively as a team.’

“He added: ‘I have a pretty good track record at doing that.’ ”

In his January 10th radio address, president-elect Obama said:

“Our first job is to put people back to work and get our economy working again. This is an extraordinary challenge, which is why I've taken the extraordinary step of working - even before I take office - with my economic team and leaders of both parties on an American Recovery and Reinvestment Plan that will call for major investments to revive our economy, create jobs, and lay a solid foundation for future growth.

“I asked my nominee for chair of the Council of Economic Advisers, Dr. Christina Romer, and the vice president-elect's chief economic adviser, Dr. Jared Bernstein, to conduct a rigorous analysis of this plan and come up with projections of how many jobs it will create - and what kind of jobs they will be.…

“The report confirms that our plan will likely save or create 3 to 4 million jobs.…

“The jobs we create will be in businesses large and small across a wide range of industries. And they'll be the kind of jobs that don't just put people to work in the short term, but position our economy to lead the world in the long-term.”

These comments from President Obama are noteworthy for several reasons. First, he suggests a level of unanimity among economists that does not exist. Second, he suggests his Administration will make decisions based on the facts, instead of ideology. Third, he suggests his plan will create jobs that are more than just temporary.

In that regard, I would note that the Congressional Budget Office released an analysis of the House stimulus bill. According to CBO, the House stimulus bill will create between

3 million and 8 million new jobs over the next three years, depending on whether the multiplier assumption is “Low” or “High.”

Given the cost of the House bill, these figures imply a very surprising, and a very troubling, result. The CBO estimate shows that it will cost between $90,000 and $250,000 per job created.

These numbers should be contrasted to those under the CBO baseline which show GDP per worker is about $100,000.

In other words, the jobs being created by the House bill could cost as much as 2.5 times more than the jobs created without the stimulus bill. There’s been a lot talk about “bang for the buck” around here. But, there doesn’t seem to be any interest in actually making sure it happens. Before we spend another $1 trillion, we ought to make sure we are getting our money’s worth.

It should also be noted that CBO’s analysis only covers 2009 through 2011. But, if you assume the ratio of employment to government spending remains the same throughout the 10-year projection period, there will be only a few thousand new jobs. Moreover, if you adopt the standard assumption that increasing the national debt by $1 trillion will crowd out private sector investment, the net result will be fewer jobs because of the stimulus bill.

I have written a letter to the CBO Director requesting an analysis of both the House and the Senate stimulus bills. This analysis will cover the full 10-year period consistent with the January baseline.

The Director has indicated that this is a very complicated process and their analysis may not be completed until next week. So, I would strongly encourage my colleagues to postpone a final vote on this bill until the Senate has had the opportunity to carefully review the CBO analysis.

Again, let me repeat what I said at the beginning. Congress needs to take action to address declining growth and rising unemployment. But, before we spend another $1 trillion, Congress must take the time to look before we leap.